



January 31, 2006

Ms. Stephanie Hillmon  
Assistant General Counsel  
Committee for Purchase From People  
Who Are Blind or Severely Disabled  
1421 Jefferson Davis Highway  
Suite 10800  
Arlington, VA 22202-3259

Dear Ms. Hillmon:

In response to the December 16, 2005 Advanced Notice of Proposed Rulemaking (ANPR), we are writing to submit comments to the Committee for Purchase From People Who Are Blind or Severely Disabled ("the Committee"). Calidad Industries, Inc. (Calidad) appreciates the opportunity to submit comments prior to the initiation of any formal rulemaking by the Committee.

Our comments respond to the Committee's questions on governance standards and executive compensation especially as it relates to the fair market price of products and services provided under the Javits-Wagner-O'Day (JWOD) Act.

#### **Qualified Agencies Have Good Governance Practices**

Calidad has already taken the initiative in setting standards for our organization to increase accountability and strengthen governance. This was accomplished with the adoption of those criteria you discuss in the ANPR. We support the adoption of best governance practices by all JWOD-producing entities. Calidad feels that any effort by the Committee in promulgating new standards should not be duplicative of existing authority and law.

The Committee states in their comments fourteen best practices as benchmarks of good governance for agencies operating under the JWOD program. A number of the best practices pertain to board members, including the composition of the board, prevention of undue board member influence, board size, term limits, diversity, and service by board members without compensation. Calidad, through its affiliate Goodwill Industries of the Greater East Bay adheres to these standards.

We address areas the Committee seeks further information outlined in the notice:

- (1) Are these criteria comprehensive and inclusive enough to effectively evaluate that a nonprofit agency demonstrates good governance practices and should be deemed qualified to participate in the JWOD program?

By law, board members have a duty of care that calls for them to attend meetings, to participate in decisions, and to be reasonably informed on matters of decision making. Calidad assesses the composition of its board periodically,

that is, whether there are sufficient members with the necessary skills, knowledge of programs, finances, and other matters. Diversity is an area Calidad takes into consideration. Our board members serve without compensation. Calidad's independent Board sets compensation of the executive director and leader staff. Our agency has a well-defined mission and the Board oversees implementation of its strategic goals. Its Board serves under term limits.

The standards in which to qualify in a JWOD program are already in place through applicable state and federal law on nonprofits, especially in the State of California under the Non-Profit Accountability Act of 2004 where Calidad is located. More governmental regulation and laws are not needed.

- (2) Are there additional criteria that should be used, or substituted for the above, to evaluate evidence of good governance practices by nonprofit agencies in the Program?

There has been a recommendation that accreditation by a third party, such as the Commission on Accreditation of Rehabilitation Facilities (CARF), be required. Outside accreditation can be recognized as evidence of good governance practices. The Committee, if using third party accreditation as a requirement then, need not expend additional resources to review matters that have been thoroughly examined by accreditation bodies. Further, a period of transition to accreditation should be allowed.

Enforcement through the IRS and state attorneys general offices exist; but both need additional resources and require increased communication between the two to help enforcement efforts. The IRS and state attorneys general should be provided with the adequate financial resources in order to enforce laws already in place.

- (3) Should accreditation by one or more state or national organizations be recognized as evidence of a nonprofit agency adhering to good governance practices without further review by the Committee?

Currently, Calidad is accredited through Goodwill Industries International, Inc. Further, Calidad is in the process to be accredited by CARF. If an agency is accredited by a recognized body, then the Committee need not review further any more evidence of good governance practices of that agency. An outside, third-party entity offers an impartial review of an agency's practices.

Supplementing this accreditation process is the NISH bi-ennial Compliance Review which determines the agency's compliance with all Federal standards applicable to the JWOD program.

- (5) Should the size and/or the annual revenue of the nonprofit agency be a factor or factors in assessing appropriate governance practices?

An agency's size should be given consideration in any discussion on governance practices to determine what is practical and reasonable. Most non-profit agencies do not rely solely on JWOD contracts for their revenue.

- (6) What is the best way to ensure that only qualified central nonprofit agencies and nonprofit agencies, with an internal structure that minimizes opportunities for impropriety, participate in the JWOD program?

Calidad recognizes that financial reporting and an integrated system of internal controls are key responsibilities of our management staff. We conduct quarterly review of our financial status with our Board of Directors as an essential and integral part of their duties. We further recognize that an annual independent examination and assessment of our finances under the supervision of an Audit Committee is a key element in maintaining our integrity and ensuring the safeguarding of community assets.

Although many of the provisions in the Sarbanes-Oxley Act are not applicable to nonprofits, Calidad believes that proactive establishment of effective fiscal management and a voluntary compliance program makes good business and governance sense. Calidad has:

1. **Financial Statements** issued monthly that report to our Board of Directors the financial position and results of our operations of the organization in accordance with generally accepted accounting principles.
2. **Internal Controls** that creates an integrated system that encompasses the effectiveness and efficiency of operations and the safeguarding of assets. An annual assessment of the internal control system is provided to our Board of Directors.
3. **Annual Audit** that engages an independent accounting firm to conduct an examination of our financial statements.
4. **Audit Committee** oversight from our affiliated Goodwill consisting of four volunteers, one of whom qualifies as a financial expert.
5. **Whistle Blower Protection** policy that includes procedures outlined for employee complaints of improper financial activity and a mechanism with which to resolve complaints.
6. **Conflict of Interest** policy that governs our officers, employees, and volunteers.
7. **Document Destruction** policy that includes financial records to be archived for a specific period of time, as well as electronic mail and voice mail. Also, we have a suggested record for retention of documents.

## **Effect of Executive Compensation on Fair Market Price Determinations**

The Committee states that Board involvement in setting the compensation of the CEO/President and other highly compensated employees is a benchmark of effective nonprofit governance practices and we agree. As per the Committee's request, we address the following questions.

- (1) What is the threshold beyond which the compensation paid to the executives in a JWOD participating nonprofit agency should be considered as influencing a proposed fair market price determination? For example, if the agency receives more than a certain percentage of its total revenue from sales through the JWOD Program, is there a compensation level (total dollars paid or total dollars paid as a percentage of total revenue) at and above which fair market price impact would be deemed to occur?
- (2) Conversely, is there a point below which executive compensation, regardless of the dollar amount paid, would not be considered as influencing a recommended fair market price? Is such a *de minimis* test appropriate for large diversified nonprofits where total JWOD sales represent only a small percentage of total revenue?

Much of the attention on executive compensation has been to highlight certain singular circumstances occurring in non-profit agencies. These examples are all reflective of extraordinarily large JWOD agencies. Based on NISH's statistics, the average size of a JWOD business is \$3.25 million in annual revenue. Yet a few JWOD agencies have grown to be much larger in size under the authority of the Committee and the Central NPA. It is here we find examples of large executive compensation packages. While Calidad is not in a position to speak to these compensation packages, it should have been expected that such packages could exist given the extraordinarily large scale of operations that have been allowed to grow under the Committee's and the respective Central NPA guidance and authority.

How a participating agency allocates the executive's compensation, as a result of the executive's contribution to the management and performance of mission and revenue-generating activities of the organization depends on size and complexity of the overall agency. With an agency with a small percentage of JWOD contracts, an executive may only spend a small percentage of their time on JWOD management duties. Calidad does not consider executive compensation per se when establishing a value on a certain contract. Since the Committee's standard procedure is to review and analyze a proposed price in the context of a competitive range of prices offered by bidders or other market pricing method, Calidad does not consider any one expense in its pricing.

Often Calidad negotiates its contract price based on one underlying fact, that is, what the Federal customer is willing to pay for its products or services. To suggest otherwise ignores the reality of how pricing actually occurs

- (3) Without regard to any analysis of JWOD-related revenue, is there an established benchmark or absolute dollar threshold above which compensation would be deemed as influencing a proposed fair market price?

Executive compensation for Calidad is determined by the organization's board of directors according to policies and procedures established by the board.

When Calidad negotiates prices for contracts it does not always recover its overhead costs through the price a customer is willing to pay. But as long as the price is greater than the variable costs of the services provided, there will be a contribution to overhead. This fact demonstrates that prices are set through a negotiation process between buyer and seller, leaving how an organization covers its overhead costs (including executive compensation) to the organization's management.

- (4) Should receipt of documentation to support a "rebuttable presumption of reasonableness" serve to demonstrate that executive compensation does not by itself influence a proposed fair market price or any adjustment thereto?

Calidad follows the guidelines from the Internal Revenue Service<sup>1</sup> in establishing a rebuttal presumption of reasonableness in relation to executive compensation. The three conditions to meet the presumptions are as follows: (1) the compensation was approved by a disinterested board or committee of the corporation or trust, (2) that obtained and relied upon appropriate data as to comparability, and (3) that adequately documented the basis for the comparison. As there is already a requirement established by Congress through the IRS, Calidad does not feel that there should be an added requirement to demonstrate compliance to the Committee.

Again, the singular instances highlighting executive compensation within the JWOD program illustrates how the Committee can be informed of outsized executive compensation. The Committee and its Central NPA's already have the information available to them. By using available information the Committee can refer these instances of executive compensation to the IRS where it feels appropriate to do so.

- (5) To what extent should there be a relationship between the pay and compensation of line workers and highly compensated individuals?

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<sup>1</sup> I.R.C. § 4958

California non-profit agencies involved with the JWOD program must follow all applicable local, state, and federal laws regarding compensation of workers in the program. These laws include the Service Contract Act and the Fair Labor Standards Act. Does the Committee really possess the resources to monitor an arbitrarily established relationship that by definition should change from circumstance to circumstance based on geographical location, demographics and state jurisdiction?

- (6) At what point would be appropriate to begin a review of an executive compensation package even if the proposed price for a product or service would fall within a range that it could be considered as a fair market price?

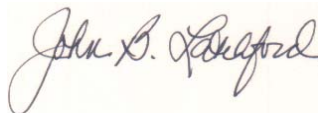
The Committee and its Central NPA already have at its disposal public information to allow it to review executive compensation. This search can be narrowed to the very large non-profit agencies that the Committee and its Central NPAs have allowed to grow to such scale. If the Committee feels that under singular situations executive compensation warrants more investigation then the Committee and its central NPA may take action on an exception basis thereby promoting efficient use of its resources. The agency's board of directors and the compensation committee should determine the appropriate time to review an executive's compensation package.

- (7) What approaches are available to identify and monitor nonprofit agencies executive compensation that would provide such information to the Committee routinely but without placing an undue burden on agencies?

The Committee has the ability to obtain this information through the Form 990 filings, which is public information.

Thank you again for the opportunity to provide input to the Committee on governance and compensation issues. We sincerely hope that once the Committee comprehends the testimony and submittals it receives to its proposed rulemaking, that it will recognize that it can achieve its intent merely by using currently available laws and regulations to control singular non-profit agencies that appear to have executive compensation issues. We look forward to continuing the dialogue.

Sincerely,



**John B. Latchford**  
Chief Executive Officer



**Michael Goetz**  
President